IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,

Plaintiff,

v.

RICHARD HAWKINS,

Defendant.
_______________________________________/

No. CR 04-106 MJJ

FINDINGS OF FACT AND CONCLUSIONS OF LAW

INTRODUCTION

Defendant Richard Hawkins was tried to the Court, without a jury, for conspiracy to commit securities fraud in violation of 18 U.S.C. § 371, for engaging in securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78(ff), and 17 C.F.R. § 240.10b-5, and for making false statements to an accountant in violation of 15 U.S.C. § 78(ff) and 17 C.F.R. § 240.13b2–2. The Government was represented by Assistant United States Attorneys Timothy Crudo and Haywood Gilliam. Defendant Hawkins was represented by William F. Alderman, Walter F. Brown, Jr., Melinda Haag, and Nancy E. Harris of Orrick, Herrington & Sutcliffe LLP. The evidentiary portion of the trial commenced on January 19, 2005, and concluded on February 25, 2005. Thereafter, the parties argued the matter and submitted the same to the Court along with their proposed findings of fact and conclusions of law. After a review of the evidentiary record, the Court now enters the following Findings of Fact and renders its Conclusions of Law and finds Defendant Hawkins **NOT GUILTY** on all counts of the Indictment.

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FINDINGS OF FACT

I. Background

A. Overview of McKesson Corporation Before the 1999 Merger With HBOC

1. McKesson Corporation is based in San Francisco, California. Before merging with HBO & Company ("HBOC") in 1999, McKesson was primarily engaged in the business of pharmaceutical distribution. McKesson had several subsidiaries or business units, the largest of which was U.S. Pharmaceuticals. McKesson Corporation's annual revenues in the 1998 timeframe were approximately $30 billion.

2. In the 1998-1999 timeframe (hereinafter, the "relevant time period"), Mark Pulido served as McKesson's Chief Executive Officer ("CEO"). Defendant Richard Hawkins became the Chief Financial Officer ("CFO") of McKesson in 1996 and served as CFO until the middle of 1999. Heidi Yodowitz served as the Controller of McKesson under Mr. Hawkins during the relevant time period.

3. Deloitte & Touche LLP ("Deloitte") served as McKesson's accounting and auditing firm before and after the merger with HBOC. Teresa Briggs, a partner at Deloitte, was Lead Client Service Partner for the McKesson account during the relevant time period. Ms. Briggs is a licensed Certified Public Accountant ("CPA"). As such, Briggs provided accounting advice on transactions to McKesson. She also had primary responsibility for supervising the Company's fiscal year-end audits, and the 1999 audit in particular. Richard Fineberg served as Advisory Partner for the McKesson account during the relevant time period. As such, Mr. Fineberg was responsible for maintaining continuity in the relationship between McKesson and Deloitte. In that role, Mr. Fineberg did not and could not provide accounting opinions or advice to McKesson.

B. Defendant Hawkins' Role at McKesson

4. As CFO of McKesson, Mr. Hawkins was responsible for McKesson's internal and external financial reporting, for the relationship with the company's outside auditors, for supervising investor relations for the company, and for the company's treasury functions. Mr. Hawkins was also involved in the issuance of McKesson securities, and in merger and acquisition activities. In addition to his responsibilities as CFO, Mr. Hawkins also had overall responsibility for the finance

function of U.S. Pharmaceuticals, McKesson's largest subsidiary.

5. It was not Mr. Hawkins' practice to contact the heads of McKesson's individual business units, including U.S. Pharmaceuticals, on a regular basis to discuss their progress toward sales and other financial goals. Instead, he relied on the reports provided to him on the third and eighth days after the close of a given quarter.

6. It was Mr. Hawkins' practice to speak and meet with Deloitte regularly regarding accounting transactions.

II. McKesson's Merger With HBOC

7. During the summer of 1998, McKesson Corporation began negotiating a possible merger with HBOC, headquartered in Alpharetta, Georgia.

A. Background on HBOC

8. HBOC was involved in the highly-profitable health care technology business (i.e. software). Before the merger, Albert Bergonzi served as HBOC's president and CEO, David Held served as HBOC's CFO, Charles McCall served as the Chairman of HBOC's Board of Directors, and Jay Lapine served as HBOC's General Counsel.

B. Historical Picture of HBOC Sales

9. Historically, HBOC, like other companies in the software industry, had experienced a hockey-stick effect in its quarterly and annual sales. This meant that most of the deals negotiated in a quarter were signed at the very end of that quarter and most of the deals occurring in a year were consummated at the very end of the fiscal year.

C. McKesson's Due Diligence In Preparation for the Merger

10. Mr. Hawkins was responsible for overseeing the financial due diligence on behalf of McKesson in connection with the proposed merger with HBOC. During the summer of 1998, McKesson retained several outside consultants, including Solomon Smith Barney, Bear Stearns, Bain & Company, McKenzie, and Deloitte, to assist in the due diligence process.

11. During that process, McKesson became aware of three issues of concern relating to HBOC's accounting practices: (1) HBOC had past due receivables on some accounts; (2) HBOC was over-accruing merger-related charges; and (3) HBOC was improperly recognizing revenue on

software maintenance fees. Neither McKesson nor the entities retained to perform due diligence learned that HBOC had a significant side letter practice.

D. The Merger Fell Through But Was Later Revived

12. The proposed merger fell through when the respective companies' stock began to trade apart, making the merger unattractive for McKesson investors.

13. The merger was revived in October 1998. McKesson and HBOC publicly announced their merger on October 18, 1998.

E. HBOC's CFO, David Held, Discovers Widespread Side Letter Practice at HBOC

14. During the fall of 1998, HBOC's CFO, David Held, became aware of a widespread side letter practice at HBOC. HBOC had been regularly recognizing revenue on contracts in which side letters, or separate agreements, that were not disclosed to accountants or auditors, contained contingencies on those contracts. Those contingencies precluded revenue recognition, but HBOC was recognizing the revenue anyway. Held was given a folder containing 50 or 60 side letters. Held destroyed the side letters and told no one what he had learned.

F. McKesson Executives Meet with HBOC Executives Just Before Merger

15. On January 6, 1999, just before the merger went through, Mr. Hawkins and Mr. Pulido met with Mr. Bergonzi, Mr. Held, and Mr. McCall in Atlanta. The day before that meeting, Held had met with McCall and Bergonzi and told them that he intended to raise some accounting issues at the January 6 meeting with Pulido and Hawkins, including HBOC's extensive side letter practice, that were of concern to him. Held prepared a proposed list (the "Options Memo") of those issues and presented it to Bergonzi and McCall on January 5. (Defense Exhibit ("Def. Ex.") 243.) One of the items listed was HBOC's side letter practice. The Options Memo reflected the following:

Must Happen

- Every remaining deal in play must come in
- Record $10.3 million in Interqual revenue accounting change (AA will challenge)
- Record all revenue with side letter contingencies
- Record all ECG processing revenue as software (5.6 million)
- Clear every judgmental reserve on the books we can find.

(*Id.*)

16. Charles McCall, the Chairman of the Board, instructed Held not to raise some of the issues listed in the Options Memo – including the side letter practice – with Hawkins and Pulido at the January 6

meeting. Held promptly prepared a revised list of topics (the "Revised Memo") for discussion at the upcoming meeting. (Government Exhibit ("Gov. Ex.") 320.) The Revised Memo does not reference a side letter or contingency problem, but says instead, "Revenue: In range of estimates." After revising the memo, Held emailed Bergonzi and attached the Revised Memo. (Def. Ex. 244.) The email said, in relevant part:

> Al
> Here it is. Revenues are 'in range of estimates'.
>
> ***
>
> Let me know if you want me in the discussion. May be better not to give him a chance to quiz me on what else is out there.

(*Id.*)

17. Held testified that at the January 6 meeting with Pulido and Hawkins, he mentioned HBOC's frequent use of side letters despite being instructed not to. Held acknowledged, however, that he told the FBI, as recently as December 2004, that he did not remember if he used the phrase "side letters" or the term "contingencies" in that meeting. Held admitted that there was a big difference between the two terms in that contingencies, unlike side letters, can be appropriate contract mechanisms that do not necessarily present accounting problems.

18. The Court finds that Hawkins and Pulido were not made aware of HBOC's side letter or contingency problem at the January 6, 1999, meeting.

19. The Court finds Mr. Held's testimony not credible for several reasons. First, because Held received a promise of leniency from the Government in exchange for his testimony, the Court examines Mr. Held's testimony with greater caution than that of other witnesses. Second, Held's inability to recount whether he specifically mentioned side letters in the January 6 meeting undermines his credibility. Third, Mr. Held's admitted longstanding awareness of the widespread side letter practice at HBOC, his destruction of 50–60 side letters in the fall of 1998, and his admitted failure to tell anyone about the side letter practice, undermines his credibility. Fourth, Mr. Held's statements in the January 5, 1999, email to Al Bergonzi – that it may be better if he is not present for the January 6, 1999, meeting so that Pulido and Hawkins have no chance to "quiz him on what else is out there" – supports a finding that Mr. Held did exactly as he was instructed and

did not expose the fraudulent accounting practices at HBOC to Pulido and Hawkins.

G. The Merger Takes Effect

20. The merger took effect, as planned, on January 12, 1999. The combined company became known as McKessonHBOC.

H. Consequences of the Merger

21. After the merger, what had been HBOC became the Information Technology Business ("ITB") unit of McKessonHBOC. The ITB unit was the only subsidiary of McKessonHBOC involved in the sale of software. After the merger, Albert Bergonzi, who had been president of HBOC before the merger, remained on as president of the ITB unit. David Held, who had been promoted to Chief Financial Officer of HBOC in October 1998, remained on as CFO of the ITB unit. Charles McCall, who had been Chairman of HBOC's Board of Directors, stayed on as Chairman of the combined company's Board. Jay Lapine, who had served as General Counsel for HBOC, stayed on as General Counsel for the ITB unit.

22. Deloitte continued to serve as McKessonHBOC's accounting and auditing firm.[1] Briggs and Fineberg retained their respective roles as Lead Client Services Partner and Advisory Partner. Ray Lockwood, a partner in Deloitte's Atlanta office, was to be the primary Deloitte contact person for McKessonHBOC's ITB unit.

23. McKesson's 1999 fiscal year ended on March 31, 1999; HBOC's 1999 fiscal year ended on December 31, 1998. The newly-formed McKessonHBOC would conform to what had been McKesson's fiscal year, and accordingly, McKessonHBOC's 1999 fiscal year would end March 31, 1999. During the quarter beginning on January 1, 1999, and ending on March 31, 1999, McKessonHBOC had securities registered pursuant to § 12(b) of the Securities and Exchange Act (15 U.S.C. § 781). McKessonHBOC stock traded on the New York Stock Exchange from the time that the merger closed through April 30, 1999, the relevant time period here.

24. In January 1999, after the merger took effect, Mr. Hawkins, Ms. Yodowitz, Ms. Briggs, and Mr. Lockwood became aware that two pre-merger HBOC contracts – totaling $5.7 million – on which revenue had been recognized by HBOC in the quarter ended December 31, 1998, contained

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[1] Before the merger, Arthur Anderson had served as HBOC's accounting and auditing firm.

contingencies. Specifically, the two transactions were contingent on the approval of the buyer companies' boards, which approval had not been obtained in the December quarter. Accordingly, Mr. Hawkins, Ms. Yodowitz, Ms. Briggs, and Mr. Lockwood determined that the revenue should not have been recognized for that quarter and reversed the revenue. Another $10 million, related to the Interqual product, that HBOC had improperly recognized as revenue before the merger was also reversed.

III. January to March 1999 – Projected Revenues, Earnings Updates, and the Market

A. The Market's Skepticism of the Healthcare Technology Field

25. During the first three months of 1999, investors were skeptical of the healthcare information services industry. Healthcare information companies were struggling. Prices for shares of stocks in the industry were underperforming in the market.

26. The market's skepticism extended to the newly-formed McKessonHBOC. The market was particularly skeptical about the McKesson-HBOC merger and did not believe that McKessonHBOC would be able to meet its financial forecasts. McKessonHBOC's stock price was volatile and declined steadily during the March quarter.

B. Projected Revenues and Earnings Updates

27. Throughout the March quarter, David Held, CFO of the ITB unit, provided Mr. Hawkins and other members of management at the parent company his written analysis of the ITB unit's financial outlook. The first analysis prepared by Held was sent to Hawkins and others on January 20, 1999, and updates were provided throughout the rest of the March quarter. Held's analyses reflected his evaluation of the ITB unit's revenue and trends.

28. As of January 20, 1999, Held forecast that the ITB unit's software revenue for the March quarter would total $155 million. (Def. Ex. 23.)

29. As of January 25, 1999, Held projected software revenue for the quarter at $140-142 million. (Def. Ex. 411.)

30. On January 25, 1999, McKessonHBOC issued an earnings release for the period ended December 31, 1999. Because $15.7 million in revenue had been reversed due to the accounting errors discovered by Hawkins, Yodowitz, Briggs, and Lockwood, HBOC did not meet consensus

guidance for software revenue for that quarter.

31. Later that day, in a conference call with analysts, Mr. Hawkins stated that McKessonHBOC's earnings per share estimate for the March 1999 quarter was $.60–.61. Mr. Pulido stated during the call that the company anticipated that the ITB unit would experience 20% revenue growth going forward. McKessonHBOC also projected that software revenue for the March quarter would reach $120 million. The $.60-.61 earnings per share guidance was based on achieving $120 million in software revenue. Internally, the software revenue goal for the quarter was set at $140-150 million to provide an incentive for ITB's sales force to complete sales. It was typical for the internal revenue goal to be higher than the public guidance.

32. On February 5, 1999, Mr. Held sent another update to management, in which he forecast that software revenue for the quarter would total $123,725,000. (Def. Ex. 26.) Mr. Held spent 3–4 hours on the telephone with Mr. Hawkins, Ms. Yodowitz, and Mr. Pulido walking through the February 5 updated analysis. Mr. Held's February 5 update revealed that only $5 million in software revenue had been recognized by McKessonHBOC (through its ITB unit) in January 1999, the first of three months in the quarter in which $120 million had been publicly projected.

33. On February 8, 1999, McKessonHBOC again stated publicly that the ITB unit was expected to grow revenues at more then 20% and expand operating margins. Mr. Hawkins and Mr. Pulido also met with analysts in New York and reiterated that the company expected $.60–.61 in earnings per share and 20% growth, including in software sales.

34. On February 23, 1999, Mr. Held sent Mr. Hawkins and others at the parent company another update of his financial analysis. He projected software revenue of $142,104,000 for the March quarter. (Def. Ex. 411.) However, at that point, less than $12 million in software revenue had been recognized for the March quarter. (Gov. Ex. 141.) Mr. Hawkins was made aware of this revenue figure in early March 1999.

35. On March 11, 1999, Mr. Held sent an update of his financial analysis to Hawkins and others, in which he projected software revenues of $126 million for the March quarter. (Def. Ex. 36.) Mr. Hawkins was aware of Wall Street rumors that McKessonHBOC was not going to make its projected numbers for the March 1999 quarter.

36. On March 12, 1999, McKessonHBOC held an analyst call to, *inter alia*, confirm that McKessonHBOC would achieve consensus estimates. The company also confirmed that it would achieve its software revenue projection of $120–130 million for the quarter. Mr. Hawkins reiterated in that call that the earnings per share estimate was $.60–.61.

37. On March 18 or 19, 1999, Held provided management, including Mr. Hawkins, with another updated projection for the ITB unit's software revenues for the quarter: $126,026,000. (Def. Ex. 476.) In that update, a potential $25 million transaction with Oracle Corporation was listed as an "upside." That $25 million would, if the deal went through, be in addition to the approximately $126 million that was being projected.

38. On March 23, 1999, Mr. Hawkins was made aware that software revenue that had been recognized for the March quarter had grown only to $40 million. However, it was common knowledge that in the software industry, most deals were negotiated and signed at the very end of the quarter.

IV. The Oracle Transaction

39. Toward the end of March 1999, McKessonHBOC and Oracle Corporation attempted to negotiate a two-sided transaction. On one side, McKessonHBOC would buy $20 million worth of Oracle database products. On the other side of the transaction, Oracle would either purchase $25 million worth of HBOC software or would pay McKessonHBOC $25 million as an exclusivity fee for access to McKessonHBOC's customer base (or "channel"). At the request of McKessonHBOC's Chief Information Officer ("CIO") Carmen Villani, Mr. Hawkins was involved in those negotiations. Mr. Bergonzi, president and CEO of McKessonHBOC's ITB unit was also involved in the Oracle negotiations.

40. After Mr. Hawkins got involved in the negotiations, he telephoned David Held, the ITB unit's CFO, and asked him to research various accounting issues related to the proposed transaction with Oracle. He asked Held to discuss the transaction with Deloitte's Atlanta office and told Held he would discuss the deal with Deloitte's San Francisco office.

41. Thereafter, in the last few days of March 1999, Mr. Hawkins contacted Teresa Briggs at Deloitte to discuss the potential Oracle deal. Mr. Hawkins told Ms. Briggs about both sides of the

transaction – that McKessonHBOC would purchase $20 million of Oracle software and Oracle would either purchase $25 million of HBOC software or would pay a $25 million exclusivity fee for access to McKessonHBOC's channel. Because the exclusivity fee option was the preferred alternative, Briggs focused her research on that. Briggs advised Hawkins that if the Oracle exclusivity payment was linked and contingent on McKessonHBOC's purchase of Oracle products, the transaction was a wash and revenue could not be recognized. She told him that separating the contracts physically would not make revenue recognition permissible. She also said, however, that if the transactions were separate so that they were not contingent upon one another (i.e. if Oracle paid an exclusivity fee for access to McKessonHBOC's channel and McKesson bought Oracle software using normal purchasing patterns that represented the fair value of the goods and services exchanged), revenue on the exclusivity fee could be recognized.

42. Ms. Briggs could not refer Mr. Hawkins to any specific authoritative accounting literature that prohibited revenue recognition on "linked" transactions. Briggs knew that "[t]here wasn't anything specifically written on that topic at the time, but [software revenue recognition on two-way deals] was one of the issues that [the Financial Accounting Standards Board's Emerging Issues Task Force] was looking at."

43. Briggs told Hawkins that to recognize revenue on the Oracle transaction, McKessonHBOC's purchase of Oracle software would need to occur in line with its historical pattern of software purchases from Oracle.

44. Mr. Hawkins understood Ms. Briggs' concerns about recognizing revenue on the Oracle deal to be that the fair value of the exclusivity fee could not be adequately ascertained such that revenue on that fee should not be recognized.

45. After speaking with Ms. Briggs, Hawkins again spoke with Mr. Held about the how to best structure the Oracle deal from an accounting perspective based on their respective research and on the advice each had been given by Deloitte and others.

46. On Thursday, March 31, 1999, the negotiations on the Oracle deal fell through and the quarter came to a close. Bergonzi and Hawkins were both on the conference call with Oracle when the deal fell through.

47. Bergonzi testified that after the Oracle conference call, in which the deal fell through, he and Hawkins spoke separately and Bergonzi informed Hawkins that the ITB unit would not meet the software revenue projections for the quarter.

48. The Court rejects Bergonzi's testimony on this point for two reasons. First, Carmen Villani, McKessonHBOC's CIO was in Mr. Hawkins' office during the conference call with Mr. Bergonzi and Oracle in which the deal fell through. Mr. Hawkins was using the speaker phone and Mr. Villani could hear both sides of the call. Villani was also in Mr. Hawkins' office for the subsequent separate phone call between Bergonzi and Hawkins. Again, Mr. Hawkins was using the speaker phone. Villani testified that Mr. Bergonzi said nothing in either call about whether the ITB unit would meet software revenue projections for the quarter without the Oracle revenue. The Court finds the testimony of Mr. Villani credible.

49. Second, Mr. Bergonzi has admitted that he began committing fraud, by backdating contracts and using side letters, sometime in 1998, long before the merger with McKesson. He pled guilty to conspiracy to commit securities fraud and securities fraud on October 16, 2003. As part of his plea agreement, the Government agreed to request, on Mr. Bergonzi's behalf, a downward departure from the sentencing guidelines in exchange for Mr. Bergonzi's substantial assistance in the investigation and prosecution of others. Accordingly, the Court examines Mr. Bergonzi's testimony with greater caution than that of other witnesses.

50. The Court finds that as of March 31, 1999, Hawkins did not know whether the ITB unit had made its numbers for the quarter.

V. The Data General Deal

A. Overview

51. Between April 1 and April 5, executives at the ITB unit of McKessonHBOC, including Al Bergonzi, the ITB unit's president and CEO, negotiated a deal with Data General ("DG"). Involved in the negotiations on the DG side were Mike Sutkowski, the DG sales representative who was responsible for the HBOC account,[2] Bob Iacona, who oversaw all medical accounts for

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[2] DG and HBOC had an ongoing business relationship before they began negotiating this particular transaction.

DG's sales department, Ethan Allen, Vice President of Sales, Bill Carroll, a finance person at DG, and Morris Nicholson, Assistant General Counsel for DG.

52. The transaction had two sides. Ultimately, the two sides of the deal were memorialized in two separate contracts. It was Bergonzi who proposed that the transaction be reflected in separate contracts.

53. On one side of the transaction, McKessonHBOC agreed to sell $20 million of software to DG for resale. This agreement (the "Software Reseller Agreement") was signed on April 5, 1999, but was backdated to March 31, 1999, so that revenue on the sale could be recognized in the March 1999 quarter. (Gov. Ex. 95.) The payment terms of the Software Reseller Agreement required DG to pay McKessonHBOC $10 million by April 8, 1999, and the remaining $10 million by July 8, 1999. (Gov. Ex. 95 at ¶ 5.1.)

54. On the other side of the transaction, memorialized in a separate document, McKessonHBOC agreed to issue to Data General purchase orders for DG hardware totaling $25 million over the course of the next fiscal year. This agreement (the "Hardware Agreement" or the "Amendment") was drafted as an amendment to the longstanding hardware sales agreement between DG and HBOC and was signed on and dated April 5, 1999. (Gov. Ex. 94.) The Hardware Agreement referenced the Software Reseller Agreement explaining that it "supersedes and modifies the terms of the Reseller Agreement as hereinafter set forth. To the extent, if any, that there is/are any inconsistency(s) between the terms of the Reseller Agreement and this Amendment the terms of this Amendment shall control." (*Id.* at ¶ 2.)

55. The Hardware Agreement contained provisions directed at the software contemplated in the Software Reseller Agreement. One of these provisions, the buyback provision, is set forth in paragraph 5 of the Hardware Agreement. The buyback provision required McKessonHBOC to repurchase all of the software it had sold to DG and use its own sales force, which already had experience selling HBOC software, to sell the software to end users. (*Id.* at ¶ 5.)

56. The Hardware Agreement also contained a right of return provision, set forth in paragraph 5(A) of the agreement. This provision gave DG the right to return any and all software to McKessonHBOC for a full refund that it had not sold by September 24, 1999. (*Id.* at ¶ 5(A).)

57. The pre-payment provisions of the Hardware Amendment required McKessonHBOC to pay DG by wire transfer: $5 million on April 9, 1999; $5 million on April 22, 1999; $10 million on July 8, 1999; and the remaining $5 million was to paid in accordance with the standard payment terms of the companies' longstanding agreement. (*Id.* at ¶ 4.)

B. Negotiating the Data General Deal – Defendant Hawkins' Involvement

1. April 1-2

58. On April 1, 1999, Bergonzi spoke by telephone with Mark Pulido, McKessonHBOC's CEO, for approximately 30 minutes. This was a regularly-scheduled call. Bergonzi testified that during that conversation, Pulido told him to find another deal to replace the Oracle transaction that had fallen through. Bergonzi testified that he told Pulido about a possible deal with Data General and that Pulido told him to pursue it and to work with Rich Hawkins on the accounting issues. Pulido denies that any deal with DG was even mentioned in that call.

59. There is no evidence corroborating Bergonzi's testimony regarding the substance of the telephone call with Mark Pulido.

60. The Court finds Mr. Pulido credible and accordingly finds that Bergonzi and Pulido did not discuss the DG deal in their telephone conversation on April 1, 1999.

61. Bergonzi testified that after speaking with Mr. Pulido, he called Mr. Hawkins on April 1 to discuss the potential DG deal.

62. Mr. Hawkins testified that the first conversation he had with Al Bergonzi about the DG deal occurred on April 2nd, not April 1st. In his Wells submission, however, Mr. Hawkins reported that this first conversation occurred on April 1st. This was an inadvertent error in Hawkins' Wells submission. After reviewing documents produced in discovery, including written communications between Bergonzi and Data General and telephone tolls, Mr. Hawkins realized that the first call with Bergonzi had occurred on April 2, 1999, not on April 1, as he had previously believed. Telephone records support Mr. Hawkins' testimony that the conversation occurred on April 2. (Gov. Ex. 123.)

63. The Court finds that the first conversation that Mr. Hawkins and Mr. Bergonzi had regarding the DG deal occurred on April 2.

64. In this first call between Bergonzi and Hawkins on April 2, Bergonzi had called Hawkins to discuss whether revenue could be recognized on an unusual software reseller agreement that the ITB unit had negotiated with Data General. Hawkins asked Bergonzi a series of questions designed to determine whether McKessonHBOC could recognize revenue. They discussed the business purpose of the transaction and Bergonzi explained that this was a strategic relationship between McKessonHBOC and Data General whereby DG would sell McKessonHBOC's software to its customer base, which would create a larger market for HBOC software because DG had access to, and the ability to penetrate, customers that HBOC did not have relationships with. Bergonzi also explained that DG had the capability to sell the software through their health care sales force. Bergonzi assured Hawkins that HBOC software had been delivered to DG on March 31, 1999. Hawkins also asked about the payment terms and learned from Bergonzi that DG would pay 50% of the $20 million within 10 days and the balance within about three months. Hawkins also asked Bergonzi whether there was a right of return on the software and Bergonzi assured Hawkins that there was not.

65. Hawkins and Bergonzi also discussed how McKessonHBOC's commitment to purchase DG hardware would work. Bergonzi informed Mr. Hawkins that McKessonHBOC's agreement to purchase $25 million of DG hardware over the course of the ensuing year was not memorialized in the same contract as the software reseller agreement but would be memorialized in a separate contract to be signed the following week. Bergonzi explained that HBOC and DG had a longstanding relationship in which HBOC would purchase hardware, on which to run HBOC software, from DG to sell to its software customers as they demanded. The previous year, HBOC had purchased $20 million in hardware from Data General and the companies expected that those sales would increase the next year. The Hardware Agreement would give Data General preferred vendor status. Hawkins asked Bergonzi whether HBOC would purchase and receive DG hardware based on HBOC customer demand or whether HBOC would maintain any inventory. Bergonzi assured Hawkins that the hardware would be purchased on an as-needed basis, just as HBOC had done in the past. Bergonzi also assured Hawkins that the price HBOC would pay for DG hardware under the agreement was consistent with HBOC's historical purchasing pattern of

DG hardware.

66. Mr. Hawkins concluded that the DG deal was similar to the Oracle deal in that there was money flowing in both directions. However, he concluded that there were two important differences. First, there already was established pricing for the products involved in the DG transaction. Second, DG was a longstanding trade partner with HBOC and McKessonHBOC was going to be buying DG hardware in line with that historical purchasing pattern, whereas Oracle was a new relationship for McKessonHBOC. Mr. Hawkins concluded that McKessonHBOC's commitment to purchase hardware did not affect the company's ability to recognize revenue on the software sale because the hardware purchases were a continuation of a pre-existing arrangement. Hawkins told Bergonzi that he would contact Deloitte.

67. Hawkins was not told that the deal was still being negotiated and would be backdated.

68. After speaking with Mr. Bergonzi, Mr. Hawkins called Rich Fineberg at Deloitte to discuss the DG deal. He had been unable to get in touch with Teresa Briggs, who was out of town, so he contacted Fineberg. Fineberg said he would alert the appropriate Deloitte people to the transaction. Ms. Briggs then called Mr. Hawkins.[3] Mr. Hawkins explained to Ms. Briggs that he had just learned from the ITB unit about a $20 million software reseller contract with DG that had been signed on March 31. He said that as a large reseller deal, the transaction was unusual, and that he wanted Deloitte to look at the accounting closely. Hawkins told Briggs that "if it worked, great. If it didn't, then they would reverse the revenue." He said he "wasn't going to push really hard on this one." Hawkins did not tell Briggs that McKessonHBOC had agreed to purchase $25 million of DG hardware during the ensuing year. Briggs told Hawkins she would get a copy of the contract from the ITB unit to begin her review of the transaction. Hawkins said that he would also contact the appropriate people at the ITB unit to get her a copy of the contract.

69. Hawkins then called Bergonzi and they had a second conversation about the DG deal. This call occurred on April 2. The only thing that was discussed in that conversation was getting a copy of the DG contract to Deloitte. Hawkins asked that a copy be sent to Deloitte's Atlanta office. Bergonzi told Hawkins that he was not in the office, did not have a copy of the contract, and to

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[3] Neither Mr. Fineberg nor Ms. Briggs remembers whether these calls occurred on April 1 or April 2.

contact David Held, the ITB unit's CFO.

70. After this second call with Bergonzi on April 2, 1999, Hawkins called David Held to ask that a copy of the DG contract be provided to Deloitte. Held said he would track it down. Mr. Hawkins said nothing in that conversation to suggest that he knew about the backdating.

2. April 3-4

71. Bergonzi testified that he spoke with Mr. Hawkins several times over the course of the weekend to update Hawkins on the negotiations with Data General. Bergonzi also testified that he, assisted by Jay Lapine, general counsel for the ITB unit, faxed drafts of the DG contract to Hawkins on Saturday afternoon, April 3. Mr. Held also testified that he spoke with Mr. Hawkins by telephone about the DG deal on April 3. Mr. Hawkins testified, to the contrary, that he never spoke with, received faxes from, or in any other way communicated with Bergonzi or Held on April 3 or April 4, 1999. The Court finds Defendant Hawkins' testimony credible.

72. The Court finds Mr. Hawkins' testimony credible and rejects Mr. Bergonzi's testimony on this point for several reasons:

(a) First, the documentary evidence does not show that any phone calls were made, that any faxes were sent, or than any emails were exchanged. (Def. Exs. 1064, 1069, 1073, 1077, 1079, 1081, 1082.)

(b) Bergonzi testified for the very first time at trial that he must have used one of the telephones in the ITB unit's office that had a pre-programmed long-distance authorization code, to explain why his calls to Hawkins did not appear on the phone tolls. Bergonzi also testified that during a 1999 interview with Skadden Arps attorneys as part of the McKessonHBOC internal investigation, he was shown a fax confirmation that corroborates his testimony that he faxed drafts of the DG agreements to Mr. Hawkins on April 3, 1999. Bergonzi had never mentioned this alleged fact until a few months before trial. Moreover, Thomas Fallati, the Skadden attorney who was largely responsible for gathering documents from, *inter alia*, Al Bergonzi, never saw a fax confirmation reflecting that a fax was sent from Bergonzi to Hawkins on April 3. Fallati was present at all three interviews with Bergonzi and has "no recollection that [Skadden] had such a fax confirmation to begin with or that [Skadden attorneys] showed one to [Bergonzi]." Mr. Fallati's practice was to take notes during the interviews. If Skadden showed Bergonzi a document, Fallati's notes reflected that. He did not record that Skadden showed Bergonzi any fax confirmation showing that a fax was sent, on April 3, 1999, from Bergonzi to Hawkins. Moreover, the parties stipulated that the Skadden database, containing all documents relevant to the internal investigation of McKessonHBOC, contains no such fax confirmation.

(c) Third, the Court finds that the testimony of Kim Bergonzi, Al Bergonzi's wife, offered to corroborate Mr. Bergonzi's testimony regarding the April 4 call, lacks credibility. Kim Bergonzi testified that during the first weekend in April 1999, Al Bergonzi (who she was dating at the time) was at her apartment and that Mr. Hawkins and Mr. Pulido called to speak with Mr. Bergonzi about the DG deal on Sunday, April 4. Ms. Bergonzi testified that when the phone rang, she answered and Mr. Hawkins said, "Hi, Kim. This is Rich. Is Al there?" However, in her initial interview with the FBI in September 1999, Ms. Bergonzi did not report that anyone named Rich had called her apartment on April 4, 1999. She also told the FBI in that initial interview that she had had no dealings with Mr. Hawkins (or anyone else at McKesson) prior to the restatement in late April 1999. Additionally, in her October 2004 interview with the FBI, Ms. Bergonzi reported that Mr. Hawkins and Mr. Pulido had called that evening and that she recognized their voices because she had met them before. However, Ms. Bergonzi did not meet either Hawkins or Pulido until late April 1999.[4]

73. The Court also finds that Mr. Held's testimony regarding an April 3 call to Defendant is not credible. First, in light of the leniency the Government has promised Mr. Held in exchange for his

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[4] The Court also rejects the testimony of Adrianne Rogers Poulard, a close friend of Ms. Bergonzi's. During the relevant time period, Poulard worked in the ITB unit as head of the Software Revenue Recognition Group. On several occasions, Ms. Poulard booked revenue on deals, including the DG deal, that she knew had been backdated. Ms. Poulard testified that on Monday, April 5, 1999, Kim Bergonzi (known, at that time, as Kim Parr) told her that Mr. Hawkins and Mr. Pulido had called her apartment over the previous weekend to talk with Mr. Bergonzi about the DG deal. However, in her two interviews with the FBI, Ms. Poulard did not report that Kim Parr had told her that Mr. Hawkins had called Parr's apartment on April 4, 1999, to speak with Mr. Bergonzi. Inconsistencies in her story, particularly in light of the Court's finding that Kim Bergonzi's testimony is not credible, undermine Ms. Poulard's credibility.

testimony, the Court views Held's testimony with caution. Second, Held's involvement in HBOC's widespread side letter practice undermines his credibility. Third, Held initially said that he spoke with Mr. Hawkins on April 2; inconsistencies in his story undermine his credibility. Finally, Mr. Held testified that he did not review the DG contracts on April 5 because he wanted to minimize his involvement in the DG deal since he knew it was improper. Mr. Held's alleged attempt to minimize his involvement in the Data General deal, a mere two days after he allegedly spoke with Mr. Hawkins regarding intimate details of that deal - a deal he knew at all times was improper - is further evidence that his testimony on this point is contrived.

74. The Court finds that after April 2, Hawkins did not speak to, receive faxes from, or in any other way communicate with Al Bergonzi or David Held until Monday, April 5, 2005.

C. Week of April 5

1. April 5 – Execution of the Agreements

75. On Monday, April 5, 1999, the two contracts memorializing the DG deal were finalized and signed.

76. The Software Reseller Agreement was backdated March 31, 1999.

77. Mr. Hawkins and Bergonzi spoke by telephone that day. Bergonzi called to ask Hawkins what he had meant by the phrase "normal course purchases," a phrase Hawkins had used in their discussion of the DG deal the prior Friday.

2. The "Cutoff" Statement

78. Mr. Held testified that he spoke again with Mr. Hawkins about the DG deal during the week of April 5 and that Hawkins said, "The only thing they can get us on is the cutoff issue." Held did not remember the context of the statement or anything else that was said, but he understood this to be an acknowledgment that Mr. Hawkins knew the contract was backdated. Hawkins testified that he never made such a statement to Mr. Held.

79. The Court finds that Mr. Held's testimony on this point is not credible for several reasons. First, the Court views Mr. Held's testimony with caution in light of the Government's promise of leniency in exchange for his testimony. Second, Mr. Held remembers nothing else about the conversation in which Mr. Hawkins allegedly made the "cutoff" statement. He could recall neither the details of the conversation nor the context in which the alleged statement was made. Third, Mr. Held destroyed

the 50–60 side letters he had been given in the fall of 1998, disclosed their existence to no one, and had an agreement with Bergonzi and McCall not to disclose the side letter problem to Mr. Hawkins or Mr. Pulido at the meeting on January 6, 1999. Finally, in three interviews with the Skadden lawyers, who were conducting an internal investigation of McKessonHBOC, Held said nothing about the purported "cutoff" statement. Those three interviews, conducted on May 12, 1999, May 20, 1999, and June 4, 1999, occurred within two months of the purported "cutoff" statement, when Mr. Held's memory of April 1999 conversations would have been fresher.

80. The Court finds that Mr. Hawkins did not make the purported "cutoff" statement.

81. The Court finds that Richard Hawkins did not know that the Software Reseller Agreement was negotiated and signed after the close of the March 1999 quarter or that it had been backdated. The Court also finds that Mr. Hawkins did not know that some of the terms of the Software Reseller Agreement were memorialized in a separate document, that he did not know about the payment terms associated with the software sale, and that he did not know that DG had a contractual right to return the software or that McKessonHBOC had agreed to buy back the software before it was delivered to the end user. The Court finds that Mr. Hawkins saw neither the Software Reseller Agreement, or the Hardware Agreement, which contained the buyback and right of return provisions, during the first week in April.

3. Deloitte's Review of the Software Reseller Agreement

82. Teresa Briggs received a copy of the Software Reseller Agreement and a business purpose letter on April 5 or 6. She reviewed the accounting literature, examining specifically Statement of Position ("SOP") 97-2, developed by the American Institute of Certified Public Accountants ("AICPA"), which is part of the Generally Accepted Accounting Principles ("GAAP"). Deloitte determined that the Software Reseller Agreement satisfied the requirements of SOP 97-2.

83. Briggs called Mr. Hawkins on April 6 or April 7 and told him that Deloitte's initial assessment of the deal was that revenue could be recognized as long as there was no *quid pro quo* and as long as there were no other terms that were not contained in the contract. According to Briggs, it would have been important for her to know about McKessonHBOC's commitment to issue purchase orders for $25 million worth of DG hardware during the next year.

84. Briggs does not believe that Hawkins told her that McKessonHBOC had committed to issue purchase orders for $25 million worth of DG hardware. Briggs testified that it would have been important for her to know about that commitment. She testified that it also would have been important for her to know that the Software Reseller Agreement had been backdated and that there were other terms of the agreement that were not contained in the Software Reseller Agreement. Specifically, it would have been important for Briggs to know that there was a contractual right of return on the software, requiring McKessonHBOC to repurchase any software that DG had not sold within six months and that there was a buyback provision, requiring McKessonHBOC to buy back the software from Data General before the software was delivered to end users.

85. The Court finds that Mr. Hawkins did not willfully omit a material fact from Ms. Briggs for several reasons. First, the hardware commitment, as it had been explained to Hawkins, did not amount to a *quid pro quo* because Mr. Hawkins had asked certain questions of Mr. Bergonzi on April 2 regarding the agreement to purchase DG hardware that satisfied his concerns about whether that agreement affected whether revenue could be recognized on the software sale. Specifically, Mr. Hawkins had learned from Bergonzi that HBOC had a longstanding relationship with DG in which HBOC had purchased DG hardware for use with HBOC's software. Mr. Hawkins was assured by Bergonzi that the price HBOC would pay for DG hardware through the agreement was consistent with HBOC's historical purchasing pattern of DG hardware. Additionally, Mr. Hawkins was assured that HBOC would purchase and receive DG hardware based on HBOC customer demand and would not maintain any inventory of DG hardware. Mr. Hawkins concluded, based on these assurances, that the DG hardware would be purchased at its fair value and that therefore, there was no problem, as Ms. Briggs had suggested there might have been with the Oracle transaction due to the difficulty in assessing the fair value of the exclusivity fee, recognizing revenue on the software sale.

86. Second, Ms. Briggs' subjective belief that it was important to her analysis of the DG transaction to know that McKessonHBOC had committed to issue purchase orders totaling $25 million for DG hardware over the course of the coming year does not necessarily render that omitted fact material. This is particularly true in light of the relevant accounting principles – APB 29, SOP 97-2, and

Financial Accounting Standard ("FAS") 48 – as explained by the defense experts, which indicate that based on what Mr. Hawkins knew at the time, revenue could be recognized on the DG transaction. Additionally, Ms. Briggs acknowledged at trial that revenue recognition for software, which was significantly more complicated than revenue recognition for pharmaceutical distribution, was a new line of business for McKesson and a new area of accounting for her.

87. Third, Mr. Hawkins did not know that the Software Reseller Agreement had been backdated, nor did he know about the right of return provision and the buyback provision or that there were any terms of related to the software sale that were memorialized in a separate document. Thus, his failure to disclose those facts to Ms. Briggs was not a willful omission.

D. April 19 – McKesson Gives Dow Jones Interview

88. On April 19, 1999, Dow Jones interviewed Mark Pulido. In that interview, Pulido conveyed that McKessonHBOC would surpass Wall Street consensus projections of $.60 per share in earnings, that there had been strong revenue growth in the ITB unit, that software revenues had significantly contributed to the company's performance, and that software revenues were up. Dow Jones published an article reflecting Pulido's statements on April 20, 1999. (Gov. Ex. 76.) Mr. Hawkins participated in the decision to disclose McKessonHBOC's March 1999 quarter earnings to the public on April 19, 1999.

89. Mr. Hawkins' decision to authorize the effective release of McKessonHBOC's financial information on April 19 was reasonable.

E. April 19-20 – The Audit Confirmation

90. On April 19, 1999, Mike Sutkowski, a Sales Vice President at Data General, received an audit confirmation letter from Deloitte. Mr. Sutkowski brought the audit confirmation to John Gavin, CFO of DG, who reviewed it. The audit confirmation was sent to DG as an accounting safeguard, to ensure that the terms of the DG transaction, as understood by the auditors (Deloitte), were accurate. The audit confirmation specifically sought to confirm that there was no right of return and that there were no side letters (i.e. terms of the agreement that were memorialized separately). (Gov. Ex. 54.)

91. On April 20, Mr. Gavin left a voice-mail message for David Held explaining that he had received an

audit confirmation from Deloitte that was "inaccurate in that it doesn't really describe the actual deal that took place between Data General and McKessonHBOC." Held alerted Bergonzi, who returned Gavin's call. Gavin explained to Bergonzi that he would not sign the confirmation and that he intended to return the confirmation to Deloitte with complete information about the DG deal (i.e. reporting that there was a right of return and reporting the existence of the April 5 Hardware Agreement).

92. Bergonzi asked Gavin to ignore the problem and to sign the confirmation as it was. Gavin said he would think about it and get back to Bergonzi.

93. On April 21, Bergonzi again asked Gavin to sign off on the audit confirmation without correcting it. When Gavin again refused, Bergonzi asked if Gavin could wait a couple of days before sending back the corrected confirmation. Gavin declined.

94. Held and Bergonzi both called Hawkins on April 20 and left messages for him. Hawkins called Held back and was told about the right of return and the audit confirmation. Hawkins also called Bergonzi back and asked why, after Hawkins had expressly told Bergonzi that there could be no right of return, there was a right of return in the DG contract. Bergonzi explained that he had agreed to a right of return as a courtesy and that he did not believe there would be any returns. Hawkins instructed Bergonzi to try to get the right of return removed and Bergonzi agreed. Hawkins asked Bergonzi if there were any other accounting problems with the deal and Bergonzi assured him that there were not.

95. On the morning of April 21, Bergonzi contacted Hawkins again to report on his discussions with DG attempting to remove the right of return from the agreement. Bergonzi reported that he had been unable to resolve the issue and suggested that Hawkins involve Charles McCall, the Chairman of the Board, who was to arrive in San Francisco later that morning. Bergonzi suggested that McCall might be able to convince DG's CEO, with whom McCall had a good working relationship, to eliminate the right of return. Hawkins asked Bergonzi to send copies of the audit confirmation and the hardware agreement and Bergonzi agreed. Those documents were faxed to Hawkins on the morning of April 21. (Gov. Ex. 113.)

96. April 21, 1999, was the first time Hawkins had seen the Hardware Agreement.

F. April 21 – Hawkins Meets With Deloitte To Discuss Accounting Problems With DG Deal

97. On April 21, after reviewing the Hardware Agreement, Mr. Hawkins called Rich Fineberg at Deloitte and said he had an accounting problem that needed immediate attention. They set up a meeting for early that afternoon. Mr. Hawkins asked Heidi Yodowitz, McKessonHBOC's Controller, to separately look at the document and assess the accounting issues from her perspective. Hawkins found Mr. McCall, who had arrived, explained the right of return problem, and asked McCall to contact Ron Skates, DG's CEO, to try to eliminate the right of return. Hawkins testified that McCall later told him that he had been unable to get Skates to eliminate the provision, but that Skates had agreed to reduce the right of return.

98. Hawkins called Bergonzi back and asked him questions about paragraph 5 and paragraph 5(a) of the Hardware Agreement, which contained a right of return and a buyback provision that related to the Software Reseller Agreement. Bergonzi explained that the buyback provision was intended only to ensure that end users of the software were aware that HBOC was providing the warranty for the product, not DG. With respect to the right of return, Bergonzi explained to Hawkins, as he had on April 2, that he felt very comfortable that the software would sell through and that there would be no returns. Bergonzi said that DG was selling adequate hardware to support selling $20 million of HBOC's accompanying software. Bergonzi also said that DG had relationships with health care companies (e.g. Columbia Health Systems), that HBOC did not have relationships with, that were likely to purchase a good deal of the software, and that DG had a strong presence abroad as well.

99. Hawkins then met with Ms. Yodowitz in Hawkins' office. Yodowitz brought relevant accounting literature with her, including SOP 97-2 and FAS 48. (Gov. Ex. 116.) Mr. Hawkins testified that he and Ms. Yodowitz reviewed the Hardware Agreement and the accounting literature and concluded that the deal was not a consignment sale because the timing of DG's payments to McKessonHBOC were not tied to DG's sales of the software to the end user. Hawkins testified that they also analyzed whether the right of return precluded revenue recognition and assessed whether the amount of returns could be reasonably estimated, one of the requirements for revenue

recognition where a right of return exists. According to Hawkins, he and Ms. Yodowitz also concluded that the provisions of the agreement relating to McKessonHBOC's commitment to issue purchase orders for $25 million in DG hardware did not preclude revenue recognition on the deal because both sides of the transaction were based on arms-length negotiations, the hardware was assessed at a fair value based on established pricing, and the purchases would be made in line with HBOC's historical purchasing patterns. There is no evidence contradicting Mr. Hawkins' testimony regarding this meeting. Accordingly, the Court finds Hawkins' testimony regarding this conversation credible.

100. Early in the afternoon on April 21, Ms. Briggs and Mr. Fineberg from Deloitte arrived at McKessonHBOC to meet with Mr. Hawkins and Ms. Yodowitz. The four walked through the relevant accounting literature and the Hardware Agreement and whether revenue could still be recognized on the software sale.

101. Deloitte had previously determined, in its early April review of the Software Reseller Agreement, that the agreement satisfied the requirements of SOP 97-2. The presence of the Hardware Agreement, and the provisions therein, created some concern about whether the fee for the software was fixed or determinable, the third requirement of SOP 97-2.

102. With respect to the right of return, Fineberg, Briggs, Hawkins, and Yodowitz talked about FAS 48 and discussed the ability to estimate returns on the software within the meaning of paragraph 6(f) of FAS 48. Hawkins' contemporaneous notes reflect that this discussion took place. Hawkins testified that he relayed to Fineberg and Briggs what he had been told by Bergonzi – that returns could be reasonably estimated at zero.

103. With respect to the buyback provision, Hawkins told Fineberg and Briggs that the buyback provision was intended only to ensure that McKessonHBOC, and not DG, would warranty the software.

104. At that April 21 meeting, Hawkins, Yodowitz, Fineberg, and Briggs discussed whether recognizing the DG revenue was error, and if so, whether that error was material. The quantitative materiality threshold for McKessonHBOC in 1999, as set by Deloitte, was $30 million. Deloitte told Mr. Hawkins that the $20 million, along with an unrelated $5 million credit, netted $15 million in passed

adjustments, which was roughly half of McKessonHBOC's materiality threshold, as calculated by Deloitte.

105. Hawkins was told by Deloitte, "On a purely quantitative basis, [Deloitte] could get to a position where [they] could say it was not material." As long as no other accounting problems were discovered, Deloitte told Hawkins, they would be able to issue an unqualified opinion even if recognizing the DG revenue was error.

106. At that meeting, Briggs, Fineberg, Hawkins, and Yodowitz also discussed qualitative materiality. Qualitative materiality assesses how an error might be perceived by readers of a financial statement. Their discussion in that regard was focused on the SEC's increasing interest in qualitative materiality.

107. At the end of the meeting, Fineberg and Briggs told Hawkins and Yodowitz that they would return to Deloitte's office to study the contracts and consult with others and that they would communicate their conclusion later on. However, Briggs and Fineberg advised Mr. Hawkins that they believed the best shot at keeping the revenue on the books was to have the Hardware Agreement rescinded and redrafted.

108. Fineberg and Briggs went back to the Deloitte offices and met with Tim Van Oppen, Chief Technical Partner for Deloitte, to review and discuss the DG transaction. Deloitte determined that unless Hawkins was able to rescind the Hardware Agreement before the earnings release scheduled for the next day, it would be error to recognize the DG revenue and that it should not be included in the earnings release. Ms. Briggs contacted Mr. Hawkins to scheduled a conference call for later that afternoon so that Deloitte could communicate their accounting conclusion. At 5pm that afternoon, as scheduled, Ms. Briggs, Mr. Fineberg, Mr. Van Oppen, Mr. Hawkins, and Ms. Yodowitz held a conference call. On that call, Ms. Briggs told Mr. Hawkins that if McKessonHBOC decided to recognize the revenue, Deloitte would place the $20 million on their passed adjustments list. Mr. Hawkins understood that because the amount on the passed adjustments list did not reach the materiality threshold, Deloitte would issue an unqualified audit opinion. Mr. Hawkins said he would discuss the issue with Mark Pulido. Ms. Briggs called Mr. Hawkins again that evening about 8 pm to find out what they had decided to do. Mr. Hawkins

informed her that they had decided to recognize the DG revenue.

G. April 22 – McKessonHBOC Issues Its Earnings Release for the March Quarter

109. McKessonHBOC's financial results for the period ending March 31, 1999, were released to the public on April 22, 1999. The earnings release was distributed by wire transmission from Business Wire's office in San Francisco pursuant to McKessonHBOC's instructions. The earnings release included $20 million in revenue from the DG deal. Mr. Hawkins reviewed, authorized, and caused the April 22 earnings release. He knew that Deloitte considered the DG revenue to be error and that Deloitte had recommended that it not be included in McKessonHBOC's earnings release. The release could have been recalled at any time prior to its release to the public on April 22. Mr. Hawkins believed that it was not error to recognize the DG revenue. He knew that he would have to explain his decision at the Audit Committee meeting just five days later.

110. Mr. Hawkins did not know that the Software Reseller Agreement had been signed on April 5, 1999, and had been backdated.

111. McKessonHBOC held a conference call with the public after the earnings were released on April 22. During that call, McKessonHBOC reported that it had achieved $.62 per share in earnings, a 21% growth rate in software and software revenue for the March 1999 quarter.

H. April 26-27 – Audit Committee Meeting in Arizona

112. Mr. Hawkins attended the long-scheduled McKessonHBOC Board meeting in Arizona. As part of that meeting, the Audit Committee, a sub-committee of the Board of Directors, also met. Mr. Hawkins gave a presentation about the Data General deal, learning about the hardware agreement which contained the right of return and buyback provisions, his decision to recognize revenue on the deal and his reasoning for doing so, and Deloitte's position. Mr. Hawkins accurately and fairly presented Deloitte's views in his presentation. Fineberg then answered the Audit Committee's questions and indicated that Deloitte believed that recognizing the Data General revenue was an error, that the revenue had been placed on a passed adjustments list, that it was not quantitatively material, and that they would render an unqualified audit opinion unless other items came to light during the completion of the audit.

113. At the Arizona meeting, Bergonzi informed Mr. Hawkins that there were other deals containing side

letters on which revenue had been improperly recognized. Hawkins immediately informed the General Counsel of McKessonHBOC and Deloitte, and had Heidi Yodowitz and David Held begin an internal investigation of all possible deals out of the ITB unit for which revenue had been improperly recognized in the March quarter. While Hawkins was trying to sort out the extent of the accounting problems at the ITB unit, Bergonzi was negotiating another side letter with the University of Pittsburgh Medical Center. During those two days in Arizona, Mr. Hawkins, Ms. Yodowitz, and Mr. Held uncovered $42 million in revenue that had been improperly recognized for the March quarter.

VI. Relevant Accounting Principles and Standards

A. Basic Principles

114. GAAP constitutes the guiding principles for the accounting profession. GAAP includes Financial Accounting Standards Board ("FASB") pronouncements, the American Institute of Certified Public Accountants' ("AICPA") Statements of Position, and FASB's Emerging Issues Task Force ("EITF") consensus. The three bodies that set accounting standards in the United States are FASB, the AICPA's Accounting Standards Executive Committee ("ACSEC"), and EITF

115. A set of financial statements is in accordance with GAAP if it "presents fairly" or reflects a reasonable application of GAAP principles.

116. In accounting for a transaction, an accountant tries to capture the underlying business or commercial purpose of the transaction rather than just the form.

117. A fundamental principle of GAAP is that revenue cannot be recognized on a transaction unless there has been a culmination of the earnings process. The earnings process does not culminate until the party to a transaction performs the obligations promised, thereby entitling that party to the benefits of the transaction.

118. In the accounting context, an "error" is an unintentional mistake in a financial statement. An "irregularity" is an intentional error in a financial statement. Accounting fraud is a material irregularity. Whether an error is material is a matter of judgment.

119. Quantitative materiality is the measurement of an accounting error against an auditor-set percentage of the company's net income. An error less than the auditor-set threshold would not be

quantitatively material.

120. Qualitative materiality is the impact that an error might have on the way that users of financial statements interpret the data. An error that might not rise to the level of quantitative materiality might still have an impact on software revenue growth or earnings per share such that it would be meaningful to readers of the financial statements, rendering the error qualitatively material. In 1999, the SEC was beginning to put more emphasis on qualitative materiality.

121. According to GAAP, revenue on a contract that was negotiated and signed after a financial period's end cannot be recognized for that prior period.

122. SOP 97-2 governs revenue recognition on software transactions. To recognize revenue on software transactions: (1) there must be persuasive evidence that an arrangement exists; (2) delivery of the software must have already occurred; (3) the vendor's fee must be fixed or determinable; and (4) collectibility must be probable.[5] (Def. Ex. 292 at ¶ .08.)

123. With respect to agreements in which the buyer has the right to return the product, SOP 97-2 incorporates FAS 48 by reference.

124. FAS 48, part of GAAP since 1981, addresses how an enterprise should account for sales of its product where the buyer has a right to return the product. (Def. Ex. 290.) FAS 48 requires that revenue on such sales may be recognized at the time of the sale only if the six criteria listed in paragraph 6 are met. One of those six requirements, as set forth in paragraph 6(e), is that the seller "does not have significant obligations for future performance to directly bring about resale of the product by the buyer." (Def. Ex. 290 at ¶ 6(e).) Another requirement, as set forth in paragraph 6(f), is that "the amount of future returns can be reasonably estimated." (Def. Ex. 290 at ¶ 6(f).)

125. Paragraph 8 of FAS 48 lists four factors that "may impair the ability to make a reasonable estimate" of returns. One of those factors is the "absence of historical experience with similar types of sales

[5] In the context of a reseller arrangement, to evaluate whether the fixed or determinable fee and collectibility criteria for revenue recognition are met, the accountant must consider, *inter alia*, whether "business practices, the reseller's operating history, competitive pressures, informal communications, or other factors indicate that payment is substantially contingent on the reseller's success in distributing individual units of the product." Additionally, "uncertainties about the potential number of copies to be sold by the reseller may indicate that the amount of future returns cannot be reasonably estimated on delivery; examples of such factors include the newness of the product or marketing channel, competitive products, or dependence on the market potential of another product offered (or anticipated to be offered) by the reseller." (Def. Ex. 292 at ¶ .30.)

of similar products, or inability to apply such experience because of changing circumstances, for example, changes in the selling enterprise's marketing policies or relationships with its customers." (Def. Ex. 290 at ¶ 8(c).)

126. APB 29, which is part of GAAP, deals with non-monetary transactions – one form of a reciprocal transaction. (Def. Ex. 291.) A non-monetary reciprocal transaction is one where goods or services are traded directly for each other and no cash changes hands. According to APB 29, as long as none of the enumerated exceptions applies, revenue should be recognized on such a transaction in accordance with the fair value of the goods or services exchanged.

127. The fair value of a transaction is the price at which one would expect a transaction to occur between a willing buyer and a willing seller. The fair value of the assets transferred must be "determinable within reasonable limits." (Def. Ex. 291 at ¶ 20.) "Fair value of a nonmonetary asset transferred to or from an enterprise in a nonmonetary transaction should be determined by referring to estimated realizable values in cash transactions of the same or similar assets, quoted market prices, independent appraisals, estimated fair values of assets or services received in exchange, and other available evidence." (Def. Ex. 291 at ¶ 25.)

128. Paragraph 21 of APB 29 enumerates exceptions to the recognition of revenue on nonmonetary transactions. Revenue should not be recognized on the nonmonetary exchange of products that are in "the same line of business" because the earnings process has not culminated. (Def. Ex. 291 at ¶ 21.)

B. Expert Testimony

1. Qualifications

129. John Lacey testified as an expert for the Government. Dr. Lacey holds a Bachelor's degree in Accountancy, an MBA in Quantitative Business Analysis, and a Ph.D in Accounting Information Systems. Dr. Lacey has served as a member of ACSEC. Dr. Lacey also worked in public accounting for two years and conducted audits. Additionally, he served as controller of a manufacturing company. For the past 25 years, Dr. Lacey has served as a professor of accounting and as an Ernst & Young research fellow at California State University, Long Beach. He teaches, among other areas of accounting, GAAP and revenue recognition.

130. Tim Lucas, who testified as an expert for the defense, holds Bachelor's degrees in Economics and Accounting and a Master's degree in Accounting. He began working as an audit staff member at Haskins & Sells (which eventually became Deloitte & Touche) and worked his way up to audit manager. As audit manager, Mr. Lucas had hands-on responsibility for conducting audits under the supervision of a partner. Mr. Lucas concurrently taught courses in the graduate accounting program at Rice University. In 1979, Mr. Lucas left Deloitte to serve as a project manager at the Financial Accounting Standards Board ("FASB"), the principal standard-setting body for the accounting profession and the primary source of GAAP. Eventually, Mr. Lucas became Director of Research and Technical Activities at FASB. As such, he chaired the Emerging Issues Task Force ("EITF"), which addressed accounting issues on which there were conflicting opinions among those knowledgeable about GAAP. During Mr. Lucas' tenure at FASB and while he served as EITF chair, SOP 97-2, developed by the AICPA, went through the FASB process and became part of GAAP. SOP 97-2 relates to revenue recognition on software transactions. Mr. Lucas now works as a private consultant on financial reporting matters and serves as chairman of the audit committee of a public company.

131. Walter Rush also testified as an expert for the defense. Mr. Rush holds a Bachelor's Degree in Business Administration. He is a licensed CPA in California and Colorado. Mr. Rush worked for 32 years at Coopers & Lybrand, where he started as a staff auditor, worked his way up to audit manager, and then became lead audit partner. As an audit partner, Mr. Rush's clients were large, publicly-held companies. Eventually, Mr. Rush became a consulting partner at Coopers & Lybrand. He also spent two years working as a professional accounting fellow at the SEC. While there, he drafted eleven staff accounting bulletins, oversaw FASB projects and mini-enforcement actions, and spoke publicly about the SEC's projects. Mr. Rush currently serves as a consultant. As such, he has had frequently encountered software revenue recognition issues.

2. Expert Testimony Regarding Relevant Principles of GAAP and the DG Deal

132. The application of GAAP requires significant professional judgment. Usually, there are a range of reasonable interpretations; there is rarely one precise right answer.

133. GAAP is not a frozen set of rules, especially in the areas of revenue recognition and reciprocal transactions. Revenue recognition, particularly software revenue recognition, has been a significant part of the EITF's agenda of emerging issues since March or April of 1999.

134. According to defense expert Tim Lucas, GAAP provisions may be directly on point with a particular transaction. However, with other transactions, GAAP provisions may only be relevant by analogy so that "when you don't find a rule that is directly on point with the issue that you have, one course for the professional accountant is to look around and see where there is an analogous situation that the literature has dealt with."

3. Recognizing Revenue on Software Transactions – SOP 97-2

135. In its early April review of the Software Reseller Agreement, Deloitte had determined that the four requirements of SOP 97-2 had been met.

136. Mr. Hawkins reasonably relied on Deloitte's conclusion that all four of SOP 97-2's criteria had been met.

4. Recognizing Revenue on Reciprocal Transactions – APB 29

137. Nothing in the authoritative accounting literature refers to "linked transactions" as that phrase was used by Teresa Briggs at trial. As of April 1999, nothing in the authoritative accounting literature dictated that revenue cannot be recognized on a transaction that is "linked" (i.e. where performance of one side of a transaction is dependent on performance of the other side creating a contingency that would prevent completion of the earnings cycle).

138. The DG deal – in which McKessonHBOC sold DG software on the one hand, and DG sold McKessonHBOC hardware on the other – could be viewed as a reciprocal transaction.

139. As of April 1999, the authoritative accounting literature did not preclude revenue recognition on a reciprocal transaction. However, if a reciprocal transaction has no underlying business or commercial purpose other than to generate revenue, revenue recognition would not be appropriate.

140. General purpose hardware and health care software are not in the same lines of business. Two things render hardware and software in different lines of business. First, hardware is a physical asset and software is intellectual property. Second, the risks associated with the respective business are considerably different.

141. The Court rejects the contrary testimony of the Government's expert, Dr. Lacey, who opined that DG hardware and HBOC software *are* in the same line of business because the products must be sold together to the end user and the products must be used together. Though qualified in other areas of complex accounting, Dr. Lacey is not sufficiently steeped in the complexities of software accounting to provide a competent expert opinion in this regard.

142. Al Bergonzi, President and CEO of the ITB unit, explained to Hawkins that the purpose of the DG deal was that DG would sell HBOC software to DG's customer base, which would create a larger market for HBOC software because DG had access to, and the ability to penetrate, customers that HBOC did not have relationships with. Bergonzi explained that the benefit to Data General was that DG would assume preferred vendor status for selling hardware to McKessonHBOC. Bergonzi also told Hawkins that the pricing of the hardware under the Hardware Agreement was consistent with HBOC's historical purchasing pattern of hardware from Data General. Bergonzi also told Hawkins that purchase orders for the hardware would be issued on an as-needed basis and that HBOC would not keep any inventory.

143. Revenue recognition is not precluded on a reciprocal transaction, with a legitimate business purpose, involving products in different lines of business that are being exchanged, and accounted for, at their fair value, which could be readily determined.

144. Hawkins reasonably concluded, based on Bergonzi's assurances, that the DG transaction had a legitimate business purpose and was not a sham designed only to recognize revenue. Hawkins also reasonably determined, based on Bergonzi's assurances that the goods were being exchanged, and accounted for, at their fair value.

5. Recognizing Revenue Where There is a Right of Return – FAS 48

145. Bergonzi assured Hawkins that there would be no returns of the McKessonHBOC software. Charles McCall, Chairman of McKessonHBOC and former Chairman of HBOC, told Hawkins that he had spoken with the CEO of Data General and had gotten the right of return reduced from $20 million to $10 million and that he would consider reducing it further.

146. Based on the estimate that there would be zero returns, the existence of the right of return provision in the Hardware Agreement would not preclude revenue recognition on the software sale under

paragraph 6(f) of FAS 48.

147. Bergonzi and McCall both had far more experience with HBOC's software sales than did Hawkins. Although Mr. Hawkins could have done more investigation of the facts and circumstances that formed the basis of Mr. Bergonzi's conclusion that there would be no returns, the record does not support a finding that Hawkins' failure to seek further corroboration of this conclusion was intentional or made with reckless disregard for the truth.

6. Recognizing Revenue Where There is a Buyback Provision – FAS 48

148. Mr. Bergonzi assured Mr. Hawkins that the buyback provision was intended only as a formality to keep the longstanding warranty arrangement between the two companies in place.

149. As a mere formality of the longstanding warranty arrangement between McKessonHBOC and Data General, the buyback provision was unusual but did not constitute a significant obligation for future performance that would preclude revenue recognition under paragraph 6(e) of FAS 48.

150. Bergonzi was more familiar with HBOC's historical relationship with DG than was Hawkins. It was reasonable for Hawkins to rely on Bergonzi's assurances with respect to the buyback provision.

151. The provision requiring McKessonHBOC to use all reasonable efforts to induce sales of the HBOC software, purchased by DG for resale, did not represent a significant obligation for future performance precluding revenue recognition under paragraph 6(e).

7. Backdating

152. Because the Software Reseller Agreement was backdated, McKessonHBOC's recognition of $20 million in Data General revenue was not in accordance with GAAP.

CONCLUSIONS OF LAW

I. General Conclusions of Law

1. The Court has jurisdiction and venue over the offenses charged in the Second Superseding Indictment ("Indictment") pursuant to 18 U.S.C. §§ 3231 and 3232 and Federal Rule of Criminal Procedure 18.

2. At all times relevant to the charges in the Indictment, 17 C.F.R. 240.13a-1 required that "[e]very issuer having securities registered pursuant to section 12 of the Act shall file an annual report on the

appropriate form authorized or prescribed therefor for each fiscal year after the last full fiscal year for which financial statements were filed in its registration statement." (February 2, 2005 Order Taking Judicial Notice ("February 2005 Order")). McKessonHBOC was subject to 17 C.F.R 240.13a-1 at all relevant times.

3. At all times relevant to the charges in the Indictment, SEC Regulation S-X (17 C.F.R. § 210.3-01(a)) required that "[t]here shall be filed, for the registrant and its subsidiaries consolidated, audited balance sheets as of the end of each of the two most recent fiscal years." (February 2005 Order). McKessonHBOC was subject to SEC Regulation S-X at all relevant times.

4. At all times relevant to the charges in the Indictment, SEC Regulation S-X (17 C.F.R. § 210.3-02(a)) required that "[t]here shall be filed, for the registrant and its subsidiaries consolidated and for its predecessors, audited statements of income and cash flow for each of the three fiscal years preceding the date of the most recent audited balance sheet being filed or such shorter period as the registrant (including predecessors) has been in existence." (February 2005 Order.)

5. The willfulness requirement, in the securities fraud context, is satisfied where a defendant acts intentionally or with "reckless disregard for the truth of material misleading statements." *United States v. Tarallo*, 380 F.3d 1174 (9th Cir. 2004).

II. Conclusions of Law Specific to the Indicted Charges

A. Count One – Conspiracy To Commit Securities Fraud in Violation of 18 U.S.C. § 371

6. To prove that Mr. Hawkins is guilty of Count 1, the Government must demonstrate beyond a reasonable doubt that:

   a. beginning on or about April 1, 1999, and ending on or about April 28, 1999, there was an agreement between Hawkins and one or more persons to commit one or all of the following offenses: (1) securities fraud, in violation of 15 U.S.C. §§ 78j(b) and 78ff; (2) making false and misleading statements and omissions of material fact in reports and documents required to be filed under the Securities Exchange Act of 1934 and the rules and regulations thereunder, in violation of 15 U.S.C. §§ 78j(b) and 78ff; (3) making materially false and misleading statements and omissions to accountants, in violation of 15 U.S.C. § 78ff and 17 C.F.R. § 240.13b2-2; or (4) wire fraud, in violation of 18 U.S.C. §§ 1343 and 1346;

   b. Hawkins became a member of the conspiracy knowing of at least one of its objects and intending to help accomplish it; and

   c. one of the members of the conspiracy performed at least one overt act for the purpose of carrying out the conspiracy.

7. The Court finds, consistent with its factual findings and its evaluation of the credibility of the witnesses, that the Government has failed to prove beyond a reasonable doubt that Defendant Hawkins entered into an agreement, with Mr. Bergonzi, or any other person, to commit any of the objects alleged in Count One of the Indictment.

B. Count Two – Securities Fraud in Violation of 15 U.S.C. §§ 78j(b) and 78(ff), 17 C.F.R. § 240.10b-5, and 18 U.S.C. § 2

8. To prove that Mr. Hawkins is guilty of Count 2, the Government must demonstrate beyond a reasonable doubt that:

   a. beginning on or about April 1, 1999 and continuing up to on or about April 27, 1999, Hawkins used a scheme to defraud someone, and made and caused McKessonHBOC to make an untrue statement of a material fact, and failed to disclose a material fact which resulted in making McKessonHBOC's statement misleading, and engaged in an act, practice or course of business that operated as a fraud or deceit upon a person;

   b. Defendant's acts and failure to disclose were in connection with the purchase or sale of McKessonHBOC stock;

   c. Defendant used the means and instrumentalities of interstate commerce, including the telephone, wires, or mails or the facilities of a national securities exchange in connection with these acts and omissions and failure to disclose; and

   d. Defendant acted willfully for the purpose of defrauding buyers or sellers of securities.

9. The Court finds, consistent with its factual findings and its evaluation of the credibility of the witnesses, that the Government has failed to prove beyond a reasonable doubt that Defendant Hawkins willfully – intentionally or with reckless disregard for the truth of material misleading statements – engaged in a scheme to defraud, as alleged in Count Two of the Indictment.

10. The Court finds, consistent with its factual findings and its evaluation of the credibility of the witnesses, that the Government has failed to prove beyond a reasonable doubt that Defendant Hawkins willfully – intentionally or with reckless disregard for the truth of material misleading statements – made or caused McKessonHBOC to make an untrue statement of a material fact, or that he failed to disclose a material fact which resulted in making McKessonHBOC's statement misleading, or that he aided and abetted the commission thereof, as alleged in Count Two of the Indictment. The facts, as found by the Court, reflect that the recognition of revenue regarding the Data General deal, when considered in light of the relevant accounting principles, and the exercise

of accounting judgment as testified to by Defendant's experts, do not support a finding beyond a reasonable doubt on this element.

11. The Court finds, consistent with its factual findings and its evaluation of the credibility of the witnesses, that the Government has failed to prove beyond a reasonable doubt that Defendant Hawkins willfully – intentionally or with reckless disregard for the truth of material misleading statements – engaged in an act, practice, or course of business which operated as a fraud or deceit upon purchasers of MckessonHBOC securities, as alleged in Count Two of the Indictment.

C. Count Three – False Statements to an Accountant or Auditor in Violation of 15 U.S.C. § 78(ff), 17 C.F.R. § 240.13b2–2, and 18 U.S.C. § 2

12. To find Defendant Hawkins guilty of County 3, the Government must prove beyond a reasonable doubt that:

a. Defendant was an officer of McKessonHBOC;

b. on or about April 6, 1999, Defendant made or caused others to make an untrue statement of material fact to McKessonHBOC's auditors or failed to disclose material facts necessary to make statements made to the auditors not misleading.

c. the statement or omission was made in connection with the preparation or filing of McKessonHBOC's annual report required to be filed for the period ended March 31, 1999; and

d. Defendant Hawkins acted willfully.

13. The Court finds, consistent with its factual findings and its evaluation of the credibility of the witnesses, that the Government has failed to prove beyond a reasonable doubt that Mr. Hawkins willfully provide false or misleading information to, or willfully omitted material information from McKessonHBOC's auditor, Deloitte & Touche, or that he aided and abetted the commission thereof, as alleged in Count Three of the Indictment.

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CONCLUSION

For the foregoing reasons, the Court finds Defendant Richard Hawkins **NOT GUILTY** on all counts of the Indictment.[6]

IT IS SO ORDERED.

Dated: July 11, 2005

MARTIN J. JENKINS
UNITED STATES DISTRICT JUDGE

[6] Defendant made two separate oral motions, pursuant to Rule 29, for a directed verdict. The Court finds Defendant Hawkins' motions moot in light of the Court's findings of facts and conclusions of law as set forth herein.